STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
TELEPHONE 916-324-6593 • FAX 916-323-3387
www.boe.ca.gov

June 18, 2007

Ms. Andrea Lynn Hoch
Legal Affairs Secretary
Office of the Governor
State Capitol
Sacramento, CA 95814

Re: Appeal of OAL Decision of Disapproval 07-0427-04 SR
Title 18 California Code of Regulations Proposed Section 474
"Petroleum Refining Property"

Dear Ms. Hoch:

This is a written request, pursuant to Government Code[1] section 11349.5, subdivision (a), for review of a denial by the Office of Administrative Law (OAL) to adopt section 474 to title 18 of the California Code of Regulations (hereinafter referred to as proposed rule 474 or the proposed rule) submitted by the Board of Equalization (BOE) (the regulatory action). The BOE respectfully requests that OAL's denial be overruled since the BOE fully complied with all the requirements set forth in the California Administrative Procedures Act (APA) (Gov. Code, §§ 11340, et seq.), and since the intent of the Legislature in creating the OAL was that it should not "substitute its judgment for that of the rulemaking agency as expressed in the substantive content of adopted regulations." (Gov. Code, § 11340.1, subd. (a).)

I. History

The Board of Equalization originally submitted the proposed Rule 474 to the Office of Administrative Law on December 26, 2006, after fully complying with the APA. The Board of Equalization withdrew the proposed rule on February 8, 2007 before the Office of Administrative Law took action on the filing. On April 27, 2007, the Board of Equalization resubmitted the regulatory action to the Office of Administrative Law. This resubmission incorporated the prior rulemaking file by reference. The only change in the resubmission from the prior rulemaking file was one minor deletion from the reference citations for section 474.

On June 8, 2007, the Office of Administrative Law disapproved the regulatory action alleging that the Initial Statement of Reasons (ISOR) was deficient for lack of stating the necessity for the regulation.

[1] All further section references are to the Government Code unless otherwise specified.

II. The BOE Complied Fully with the APA, Including Stating the Necessity for the Proposed Rule in its Initial Statement of Reasons

The adoption of regulations by a state agency must satisfy requirements established by the APA and is subject to OAL review for compliance with the procedural requirements of the APA and for compliance with the standards for administrative regulations in section 11349.1. However, in performing its review, OAL is limited to the rulemaking record and may not substitute its judgment for that of the rulemaking agency with regard to the substantive content of the regulation.

Section 11349.1, subdivision (a)(1) requires proposed regulations to meet a "necessity" standard, stating that:

> Necessity means the record of the rulemaking proceeding demonstrates by substantial evidence the need for a regulation to effectuate the purpose of the statute, court decision, or other provision of law that the regulation implements, interprets, or makes specific, *taking into account the totality of the record.* (Emphasis added.)

Section 11346.2, subdivision (b)(1) requires every agency to submit to OAL an initial statement of reasons for proposing the adoption of the regulation which must include, among other items, "a statement of the specific purpose of each adoption . . . and the rationale for the determination by the agency that each adoption . . . is reasonably necessary to carry out the purpose for which it is proposed."

In this case, the ISOR submitted with the regulation is adequate as drafted, particularly when read in conjunction with the draft rule, which was provided to the interested parties concurrently with the ISOR. The ISOR states that "The Board of Equalization proposes to adopt Rule 474 to clarify and make specific certain specialized appraisal techniques for the valuation of real property, personal property, and fixtures used to refine petroleum." Rule 474 also clearly and explicitly states the rule's necessity: "The unique nature of property used for the refining of petroleum requires the application of specialized appraisal techniques designed to satisfy the requirements of article XIII, section 1 and article XIII A, section 2, of the California Constitution. To this end, petroleum refineries and other real and personal property associated therewith shall be valued pursuant to the principles and procedures set forth in this section."[2]

Thus, the ISOR states the purpose for the rule (i.e., implement special rules for valuing petroleum refinery property) and also states (1) the Constitutional necessity for fair market value assessment and the concurrent necessity that an appropriate appraisal unit be utilized; and (2) the resulting necessity to adopt the rule to clarify and make specific certain specialized appraisal techniques for valuing petroleum refinery property, which "special appraisal" provisions are expressly stated (i.e., to "establish a rebuttable presumption for purposes of recognizing declines in value that fixtures and machinery and equipment classified as improvements for petroleum refining property are part of the same appraised unit as the land and structures"). Not only are

[2] The text of the proposed rule goes on, of course, to state the specialized appraisal techniques in detail.

the rule's express terms included in the ISOR, but such terms remain unchanged and unmodified in the proposed rule text up to the present date.

Furthermore, as recognized by OAL itself, the ISOR is required by the APA in order to provide the public with an opportunity to review and comment upon an agency's perceived need for a regulation. (Disap. Dec. 07-0427-04 SR, p. 2.) Thus, an ISOR is designed to be an initial brief statement that puts the public on notice of the subject matter that the agency intends to address in the proposed rulemaking. And it may be supplemented with the Final Statement of Reasons (FSOR), if necessary. (Gov. Code, § 11346.9, subd. (a)(1).) This is consistent with the statutory scheme requiring that a determination of "necessity" be made *taking into account the totality of the record.* (Gov. Code, § 11349.1, subd. (a).)

Public participation during the rulemaking process clearly demonstrates that adequate public notice was provided and that there was no confusion as to the subject matter of proposed Rule 474. Oral and/or written comments were received by, among others, Los Angeles County Assessor and former President of the California Assessors' Association Rick Auerbach, Contra Costa County Assessor Gus Kramer, Deputy Sacramento County Counsel Thomas Parker representing Sacramento County and the California Assessors' Association, the Western States Petroleum Association, the California Chamber of Commerce, the California Manufacturers and Technology Association, and the California Taxpayer's Association. Collectively, these participants represent the bulk of the parties that would be interested in proposed Rule 474, representing both the government's and taxpayer's interests.

The comments clearly demonstrate that the interested parties – assessors and petroleum refiners alike – clearly recognized that the proposed rule was premised upon a need to consistently value refineries as single integrated units for property tax purposes, which would have the general effect of raising the annual property taxes of refineries in the State of California. This statement can be confirmed by a review of the Rulemaking File, particularly with respect to the interested parties' comments and letters.

Therefore, the ISOR meets the requirement of putting the public on notice as well as stating the necessity for the proposed rule. However, even if it does not sufficiently state proposed Rule 474's necessity, as OAL alleges, the totality of the record clearly establishes the proposed section's need, and thus the requirements of the APA have been met. This is especially true since OAL has never asserted that either the FSOR, or the remainder of the rulemaking record, is deficient in stating the necessity of the proposed section, or in any other way.

Since the ISOR, as well as the totality of the record, clearly demonstrates the need for proposed section 474, OAL's disapproval determination should be overruled.[3]

---

[3] We note, in passing, that OAL does not seem to be consistent in its approach to ISORs and the need for a detailed statement of necessity. To offer just one example out of many, take Regulations 45000, et seq., of the Board's Cigarette and Tobacco Products Tax Regulations, effective April 2007. The ISOR of those regulations contain such "statements of necessity" as; (1) "This regulation is necessary to provide guidance to persons affected by the Act;" and (2) "The level of specificity in the regulation is provided to assist the understanding of the person from whom product may be seized." The apparently lenient standard applied by OAL to the Cigarette regulations vis-à-vis the rigorous standard applied to Rule 474 raises the question: why is Rule 474 being given harsher treatment and greater scrutiny than other regulations?

III. Even if the ISOR was not Sufficient as Drafted, the APA Allows Nonsubstantive Changes to the ISOR Without a 15-day Comment Period or Readoption by the State Agency

In addition to OAL's erroneous determination that proposed section 474's ISOR is inadequate, OAL also makes an erroneous legal determination as to the procedures required by the APA upon supplementing an ISOR.

OAL states that:

> In that the 45-day comment period had already been completed, Board staff were advised by OAL in early February, prior to the withdrawal of the original submission of this rulemaking, that the defect could be remedied by making the information required to be contained in the Initial Statement of Reasons available to the public for a 15-day written comment period pursuant to sections 11346.8(d) and 11347.1 of the Government Code. . . . In the event any comments are received by the agency on the documents during the 15-day comment period, Government Code section 11346.8(a) would require that the comments be considered by the agency prior to adoption. (Disap. Dec. 07-0427-04 SR, p. 3.)

OAL cites section 11346.8, subdivision (d), as authority for the requirement that a change to the ISOR must be made available for a 15-day comment period. However, that subdivision can not reasonably be read to apply in this situation. Section 11346.8, subdivision (d) provides that:

> No state agency shall add any material to the record of rulemaking proceeding after the close of the public hearing or comment period, unless the agency complies with Section 11347.1. *This subdivision does not apply to material prepared pursuant to Section 11346.9.* (Emphasis added.)

Section 11346.9 requires an agency to submit a FSOR with the rulemaking record when submitting a regulation for review. That section also allows changes to the ISOR to be made when submitting the FSOR. Section 11346.9, subdivision (a)(1) allows changes to the ISOR – but only requires a 15-day comment period (as provided for in section 11347.1) – when an update to the ISOR:

> [I]dentifies *any data or any technical, theoretical or empirical study, report, or similar document on which the agency is relying* in proposing the adoption, amendment, or repeal of a regulation *that was not identified in the initial statement of reasons, or which was otherwise not identified or made available for public review prior to the close of the public comment period.* . . . (Emphasis added.)

These provisions make clear the that an ISOR can be amended with the FSOR, and that *a 15-day comment period is required only when a substantive change to the ISOR is made.* Significantly, in permitting such augmentation, the statutes do not impose a requirement for

either a new adoption vote or new public hearing to consider the augmenting information. Rather, the interested parties need only be given notice and an opportunity to comment on augmenting materials, and the agency must respond to any comments received in an updated FSOR.

We also note that no additional information that would require a 15-day comment period is being required to be added by OAL, nor has BOE proposed to add this type of information. Thus, in this case, even if BOE amended the ISOR to buttress the necessity statement, no 15-day comment period would be required since the change could be made with the submission of the Final Statement of Reason or FSOR and any change would not be substantive. It would merely be restating the reasons for necessity already contained in the ISOR and the total rulemaking record.

Furthermore, OAL's construction of the APA ignores subdivision (c) of section 11346.8 which provides that "[n]o state agency may adopt, amend, or repeal a regulation which has been changed from that which was originally made available to the public pursuant to Section 11346.5, unless the change is (1) *nonsubstantial* or solely grammatical in nature, or (2) *sufficiently related to the original text that the public was adequately placed on notice that the change could result from the originally proposed regulatory action.*" (Emphasis added.)

OAL also ignores Government Code section 11349.4, subdivision (a) which specifies that, even after an initial denial by OAL, readoption by an agency is required ***only if*** an agency makes a significant substantive change to the text of the rule itself (or if a resubmittal is not made within 120 days of the written denial). Thus, the APA allows changes even to the regulation itself as long as the change is nonsubstantial or does not substantively change the regulation. By adding the requirement of a 15-day comment period and readoption for a nonsubstantive change *to an ISOR*, OAL is exceeding its statutory authority and placing burdens upon state agencies not contemplated by the APA. We note again that in this case, there has been *no* change to the rule text (save the nonsubstantial reference removal).

In your review, we would urge you to closely read *Californians for Safe Prescriptions v. California State Board of Pharmacy* (1993) 19 Cal. App. 4th 1136. In that case, after regulations were rejected by OAL, the agency amended the regulations without holding another public hearing; litigation ensued. The court backed the agency, however, and rejected OAL's arguments, finding that an agency may rewrite and resubmit regulations without complying with the notice and public hearing requirements of the Administrative Procedure Act, unless substantive provisions of the regulations have been significantly changed. In finding that the amended regulations resubmitted to OAL did not contain significant changes as alleged by appellant, the court of appeal held that no new public hearing was required: *"All of [appellant's] contentions are without merit as appellant either misconstrues the regulations or fails to acknowledge that the issues raised by the amendments were in fact addressed at the public hearing and the amendments thus could have been anticipated from the existing record of the originally proposed regulatory action and the public hearing thereon .... Pursuant to Government Code section 11346.8 and 11349.4(a), taken together, such an additional public hearing was only required if there was a substantive change to the regulation which was not sufficiently related to the original text of the regulation that the public was adequately placed on notice that the change could result from the originally proposed regulatory action."* In other

words, even an otherwise post-public hearing substantive change to regulatory text need not be subject to a second public hearing if the circumstances indicate that the public was placed on notice that such a change might be forthcoming. In this case, we note that:

(a) The public was given adequate notice of the purpose and content of the proposed rulemaking in the ISOR, and both the necessity for the proposed rulemaking and the proposed special appraisal techniques were explicitly stated in the proposed rule that was distributed with the ISOR. Any post-adoption amendment to the ISOR adding a necessity section would be repetitive and unnecessarily duplicative;

(b) The substance of the proposed enhanced "statement of necessity" that OAL asserts must be added to an amended ISOR could have been (and in fact was) anticipated by the public, as evidenced by the number and substance of the public comments, both from parties supporting and opposing the rule;

(c) The ISOR could be amended as OAL initially proposed without substantially or significantly changing the rule in any way; and

(d) The substance of the rule was not changed between initial publication and final adoption.

In communications with an OAL attorney, that attorney expressed a concern that a finding that the Board's ISOR was adequate in this case would establish a precedent that a "state agency [would be] free to completely withhold its reasons for a particular regulation from the initial statement of reasons and thereby the public and wait until after the public comment period is over to provide its reasons in the final statement of reasons which is not made available to the public for comment." We note, however, that this statement lacks persuasiveness as it obviously is inapplicable here as the text of the rule itself contains an express statement of the necessity for the rule. Furthermore, as explained above, all parties were on notice as to the stated necessity of the Rule; and finally, the Board of Equalization acted in good faith, following well-established procedures in a manner consistent with OAL's acceptance of prior proposed rules. Thus, it cannot logically or sincerely be stated here that the Board was or is in any way withholding any information from the public.

IV. Conclusion

In conclusion, we respectfully request that OAL's disapproval of proposed section 474 be overruled. In particular, we urge that you overrule OAL's decision with respect to the asserted requirement of a readoption of the Rule if the Board decides to amend the ISOR. This part of the decision, in particular, is completely unsupported and stands in opposition to both the statutes and the case law. The ISOR, as well as the rulemaking record, clearly indicate compliance with all provisions of the APA, including the need to state and give notice of the necessity for the proposed rule. Further, OAL, in requiring a 15-day comment period and Board readoption in response to comments to a nonsubstantive change to an ISOR, burdens state agencies with

requirements not found in any statutory or judicial authority. Allowing the OAL such wide latitude sets a dangerous precedent, exceeds the OAL's statutory mandate, and usurps the legislature's authority.

If you have any questions, please call me at 916.324.6593.

Sincerely,

Robert Lambert
Acting Assistant Chief Counsel

RL:jlh
Rules/474/07/Appeal to OAL.474.doc
Enclosures

cc: Susan Lapsley
Office of Administrative Law
300 Capitol Mall, Suite 1250
Sacramento, CA 95814-4339

Mr. Ramon Hirsig	(MIC:73)
Ms. Kristine Cazadd	(MIC:83)
Mr. David Gau	(MIC:63)
Mr. Dean Kinnee	(MIC:64)
Mr. Todd Gilman	(MIC:70)
Ms. Diane Olson	(MIC:80)

STATE OF CALIFORNIA
STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
TELEPHONE 916-324-6593 • FAX 916-323-3387
www.boe.ca.gov

May 7, 2007

Ms. Linda Brown, Deputy Director
Office of Administrative Law
300 Capitol Mall, Suite 1250
Sacramento, CA 95814-4339

Re: Proposed Rulemaking
Title 18, Public Revenue, Property Tax Rule 474
"Petroleum Refining Property"

Dear Ms. Brown:

We have submitted under separate cover, for approval by your office, the Board of Equalization's proposed Property Tax Rule 474, "Petroleum Refining Properties," with the following change only: In the text of the proposed rule, Revenue and Taxation Code section 53.5 is removed from the Reference section. The balance of the previously submitted materials is incorporated by reference. We request that the Office of Administrative Law (OAL) approve and finalize proposed Rule 474 with this modification.

Earlier this year, your office stated that the Board could either voluntarily withdraw the previously submitted version of the rule – that is, including the now-deleted reference to section 53.5 – or OAL would reject it. The purported reason for rejection given was that the Initial Statement of Reasons (ISOR) allegedly failed to state expressly a necessity for the rulemaking. At that time, your office also informed me and my colleague Tax Counsel Richard Moon that, due to such alleged failure, the Board staff would need to: (1) redraft the ISOR to expressly state the rule's necessity to OAL's satisfaction; (2) mail copies of the redrafted ISOR to the interested parties; and (3) if comments were received from the interested parties, submit those comments to the Board at a public hearing and request that the Board readopt the proposed rule.

After reviewing the applicable law, however, we have concluded that the previously submitted ISOR is adequate as drafted, particularly when read in conjunction with the draft rule, which was provided to the interested parties concurrently with the ISOR. The ISOR states that "The Board of Equalization proposes to adopt Rule 474 to clarify and make specific certain specialized appraisal techniques for the valuation of real property, personal property, and fixtures used to refine petroleum." Rule 474 also clearly and explicitly states the rule's necessity: "The unique nature of property used for the refining of petroleum requires the application of specialized appraisal techniques designed to satisfy the requirements of article XIII, section 1 and article XIII A, section 2, of the California Constitution. To this end, petroleum refineries and other real and personal property associated therewith shall be valued pursuant to the principles and procedures set forth in this section."

Our conclusion that OAL is incorrect in the legal positions previously communicated to the Board in this matter is based upon the following opinions and conclusions of the Board's legal staff:

1. An ISOR is designed to be an initial brief statement that puts the public on notice of the subject matter that the agency intends to address in the proposed rulemaking. Also, it is specifically intended that the ISOR will be supplemented in the Final Statement of Reasons (FSOR). In this case, OAL does not assert that the FSOR needs amendment, supplementation, or republication.[1]

2. In this case, the ISOR provided the public with adequate notice of the necessity for the proposed rulemaking. The ISOR, as originally published, states the purpose for the rule (i.e., implement special rules for valuing petroleum refinery property) and also states (1) the Constitutional necessity for fair market value assessment and the concurrent necessity that an appropriate appraisal unit be utilized and (2) the resulting necessity to adopt the rule to clarify and make specific certain specialized appraisal techniques for valuing petroleum refinery property, which "special appraisal" provisions are expressly stated: to "establish a rebuttable presumption for purposes of recognizing declines in value that fixtures and machinery and equipment classified as improvements for petroleum refining property are part of the same appraised unit as the land and structures." Thus, not only are the rule's express terms included in the ISOR, but such terms remain unchanged and unmodified in the proposed rule text up to the present date. Consequently, the public was provided with adequate notice of the proposed rulemaking. Certainly, the interested parties – assessors and petroleum refiners alike – clearly recognized that the proposed rule was premised upon a need to consistently value refineries as single integrated units for property tax purposes, which would have the general effect of raising the annual property taxes of refineries in the State of California. This statement can be confirmed by a review of the Rulemaking File, particularly with respect to the interested parties' comments and letters.

3. Even if we assume for argument's sake that an express statement of necessity was inadvertently omitted from the ISOR, the ultimate issue is notice to the public and to the interested parties. (*Californians for Safe Prescriptions v. California State Board of Pharmacy* (1993) 19 Cal. App. 4th 1136.) In this case, explicit notice of the proposed rule's necessity was provided in the text of Rule 474, which also was published and mailed to the interested parties with the ISOR: "The unique nature of property used for the refining of petroleum requires the application of specialized appraisal techniques designed to satisfy the requirements of article XIII, section 1 and article XIII A, section 2, of the California Constitution. To this end, petroleum refineries and other real and personal property associated therewith shall be valued pursuant to the principles and procedures set forth in this section."

[1] OAL's purported distinction between changes to the ISOR and changes to the FSOR lacks substance or statutory support. Given that such changes would both be added post-adoption, there would be no difference vis-à-vis the paramount element of notice to the public.

4. No statutory support has been provided for OAL's legal position. OAL points to Government Code section 11346.8, subdivision (a), which provides that: "The state agency shall consider all relevant matter presented to it before adopting, amending, or repealing any regulation." In this matter, this provision is irrelevant: the rule has already been adopted and the Board does not propose either to amend or repeal it. Furthermore, OAL's construction of this statute ignores the following statutory provisions:

   First, subdivision (c) of section 11346.8 provides that "[n]o state agency may adopt, amend, or repeal a regulation which has been changed from that which was originally made available to the public pursuant to Section 11346.5, unless the change is (1) nonsubstantial or solely grammatical in nature, or (2) sufficiently related to the original text that the public was adequately placed on notice that the change could result from the originally proposed regulatory action." [Emphasis added.] In this case, there is no change to the rule text (save the nonsubstantial reference removal).

   Second, subdivision (d) of section 11346.8 provides that "[n]o state agency shall add any material to the record of the rulemaking proceeding after the close of the public hearing or comment period, unless the agency complies with Section 11347.1. This subdivision does not apply to material prepared pursuant to Section 11346.9." (Section 11346.9 provides the requirement of an FSOR.) Section 11347.1 relates to the addition of any technical, theoretical, or empirical study, report, or similar document after publication. In this case, no additional information of this kind is proposed to be added to the rulemaking file.

5. Contrary to OAL's apparent interpretation, section 11346.8, subdivision (d) clearly contemplates and permits augmentation of the record after the agency hearing, provided that certain specified statutory requirements are met. Significantly, in permitting such augmentation, the statutes do not impose a requirement for either a new adoption vote or new public hearing to consider the augmenting information. Rather, the interested parties need only be given notice and an opportunity to comment on augmenting materials, and the agency must respond to any comments received in an updated FSOR. In addition, section 11346.9 provides that the FSOR can update the ISOR, and section 11346.8, subdivision (d) clarifies that the FSOR can include materials added after the hearing. Thus, even if an FSOR is updated with new technical or empirical information obtained after the public hearing, section 11347.1 compliance will suffice to permit the augmentation: neither agency readoption nor a second public hearing is required. Most importantly, section 11349.4, subdivision (a) specifies that a new hearing and further Board action may be required **only if** an agency makes a significant substantive change to the text of the rule itself.

6. Section 11349.4, subdivision (a) provides that: "A regulation returned to an agency because of failure to meet the standards of Section 11349.1, because of an agency's failure to comply with this chapter may be rewritten and resubmitted ... without complying with the notice and public hearing requirements ... unless the substantive provisions of the regulation have been significantly changed." Thus, the applicable statutes clearly only require a new public hearing and thus further Board action when an agency makes significant substantive changes to the rule itself. In this case, there are no substantive changes.

7. We would urge OAL to reveiw *Californians for Safe Prescriptions v. California State Board of Pharmacy* (1993) 19 Cal. App. 4th 1136. In that case, after regulations were rejected by OAL, the agency amended the regulations without holding another public hearing; litigation ensued. The court backed the agency, however, finding that an agency may rewrite and resubmit regulations without complying with the notice and public hearing requirements of the Administrative Procedure Act, unless substantive provisions of the regulations have been significantly changed. In finding that the amended regulations resubmitted to OAL did not contain significant changes as alleged by appellant, the court of appeal held that no new public hearing was required: "All of [appellant's] contentions are without merit as appellant either misconstrues the regulations or fails to acknowledge that the issues raised by the amendments were in fact addressed at the public hearing and the amendments thus could have been anticipated from the existing record of the originally proposed regulatory action and the public hearing thereon .... Pursuant to Government Code section 11346.8 and 11349.4(a), taken together, such an additional public hearing was only required if there was a substantive change to the regulation which was not sufficiently related to the original text of the regulation that the public was adequately placed on notice that the change could result from the originally proposed regulatory action." In other words, even an otherwise post-public hearing substantive change to regulatory text need not be subject to a second public hearing if the circumstances indicate that the public was placed on notice that such a change might be forthcoming. In this case, we note that,:

   (a) The public was given adequate notice of the purpose and content of the proposed rulemaking in the ISOR, and the necessity for the proposed rulemaking was explicitly stated in the proposed rule that was distributed with the ISOR. Any post-adoption amendment to the ISOR adding a necessity section would be unnecessarily duplicative; and

   (b) The statement of necessity that OAL asserts is required to be more explicitly set forth in an amended ISOR could have been (and in fact was) anticipated by the public, as evidenced by the number of public comments from parties supporting and opposing the rule that addressed in some respect the necessity of the rule; and

   (c) The ISOR could be amended as OAL initially proposed without substantially or significantly changing the rule in any way; and

   (d) The substance of the rule was not changed between initial publication and final adoption.

8. In communications with an OAL attorney, that attorney expressed a concern that a finding that the Board's ISOR was adequate in this case would establish a precedent that a "state agency [would be] free to completely withhold its reasons for a particular regulation from the initial statement of reasons and thereby the public and wait until after the public comment period is over to provide its reasons in the final statement of reasons which is not made available to the public for comment." We note, however, that this statement lacks persuasiveness as it obviously is inapplicable here as the text of the rule itself contains an express statement of the necessity for the rule. Furthermore, as explained above, all parties

were on notice as to the stated necessity of the Rule; and finally, the Board of Equalization acted in good faith, following well-established procedures and consistent with OAL acceptance of prior proposed rules. Thus, it cannot logically or sincerely be stated here that the Board is in any way withholding any information from the public.

In conclusion, we urge OAL to approve the rule in its present form – that is, with the requested deletion of the statutory reference – without the necessity of submitting an amended ISOR. If OAL still determines that a change to the ISOR be made, we urge OAL to require, at most, a new 15-day period followed by Board staff responding to any public comments in the FSOR, without the necessity for holding a new Board hearing and/or obtaining a new Board adoption vote. (See Gov. Code § 11346.8, subd. (d).) If OAL finds that a change to an ISOR necessitates a new Board hearing and/or new Board adoption vote, then we respectfully ask for citation to statutory or case law authority in support of such finding.

If you have any questions, please call me at 916.324.6593. Thank you for taking this letter into consideration in this matter.

Sincerely,

Robert Lambert

Robert Lambert
Acting Assistant Chief Counsel

RL:jlh
Prop/Rules/474/2007/OAL Rule 474.doc

cc: Mr. Craig Tarpenning
Office of Administrative Law
300 Capitol Mall, Suite 1250
Sacramento, CA 95814-4339

Mr. Ramon Hirsig	(MIC:73)
Ms. Kristine Cazadd	(MIC:83)
Mr. David Gau	(MIC:63)
Mr. Dean Kinnee	(MIC:64)
Mr. Todd Gilman	(MIC:70)
Ms. Diane Olson	(MIC:80)

RULE 474. PETROLEUM REFINING PROPERTIES.

Authority Cited: Section 15606(c), Government Code
Reference: Article XIII, Section 1, and Article XIII A, Section 2, California Constitution
Sections 51, 53.5, and 110.1, Revenue and Taxation Code

(a) The provisions of this rule apply to the valuation of the real property, personal property, and fixtures used for the refining of petroleum.

(b) GENERAL.

(1) The unique nature of property used for the refining of petroleum requires the application of specialized appraisal techniques designed to satisfy the requirements of article XIII, section 1, and article XIII A, section 2, of the California Constitution. To this end, petroleum refineries and other real and personal property associated therewith shall be valued pursuant to the principles and procedures set forth in this section.

(2) Notwithstanding any other provision in this section, any appropriate valuation method described in section 3 of title 18 of this code may be applied in the event of a change in ownership in a petroleum refining property.

(c) DEFINITIONS. For the purposes of this section:

(1) "Petroleum refining property" means any industrial plant, including real property, personal property, and fixtures, used for the refining of petroleum, as identified in Standard Industrial Classification (SIC) System Codes 2911 and 2992, or North American Industry Classification System (NAICS) Codes 32411 and 324191.

(2) "Appraisal unit" consists of the real and personal property that persons in the marketplace commonly buy and sell as a unit.

(d) DECLINES IN VALUE. For the purposes of this section:

(1) Declines in value of petroleum refining properties will be determined by comparing the current lien date full value of the appraisal unit to the indexed base year full value of the same unit.

(2) The land, improvements, and fixtures and other machinery and equipment classified as improvements for a petroleum refining property are rebuttably presumed to constitute a single appraisal unit, except when measuring declines in value caused by disaster, in which case land shall constitute a separate unit.

(3) In rebutting this presumption, the assessor may consider evidence that:

(A) The land and improvements including fixtures and other machinery and equipment classified as improvements are not under common ownership or control and do not typically transfer in the marketplace as one economic unit; or,

(B) When the fixtures and other machinery and equipment classified as improvements are not functionally and physically integrated with the realty and do not operate together as one economic unit.

INITIAL STATEMENT OF REASONS
NON-CONTROLLING SUMMARY

Property Tax Rule 474
Petroleum Refining Properties

Specific Purpose

The purpose of the proposed rule is to implement and make specific the requirements for valuation of real property, personal property, and fixtures used to refine petroleum.

Factual Basis

Section 1 of article XIII of the California Constitution provides that, unless otherwise provided by the California Constitution or the laws of the United States, all property is taxable and all assessed property is taxed in proportion to its full value. Subdivision (b) of section 2 of article XIII A of the California Constitution requires that the base year value of assessed property may not increase annually by more than the inflation factor prescribed in that subdivision.

Section 51 of the Revenue and Taxation Code implements these provisions by establishing methods for adjusting the base year values of assessed real property. Subdivision (d) of section 51 provides that "real property" means "that appraisal unit that person in the marketplace commonly buy and sell as a unit, or that is normally valued separately."

The Board of Equalization proposes to adopt Rule 474 to clarify and make specific certain specialized appraisal techniques for the valuation of real property, personal property, and fixtures used to refine petroleum.

Proposed Rule 474 will (1) define "petroleum refining property;" and (2) establish a rebuttable presumption for purposes of recognizing declines in value that fixtures and machinery and equipment classified as improvements for a petroleum refining property are part of the same appraisal unit as the land and structures. The presumption must be overcome before fixtures are treated as a separate appraisal unit for declines in value, except when measuring declines in value caused by disaster, in which case land constitutes a separate appraisal unit.

NOTICE IS HEREBY GIVEN:

The State Board of Equalization, pursuant to the authority vested in the Board by section 15606 of the Government Code, proposes to adopt Rule 474, Petroleum Refining Properties, in Title 18, Division 1 of the California Code of Regulations. A public hearing on the proposed regulations will be held in Room 121, 450 N Street, Sacramento, at 1:30 p.m., or as soon thereafter as the matter may be heard, on September 26, 2006. Any person interested may present statements or arguments orally at that time and place. Written statements or arguments will be considered by the Board if received by September 26, 2006.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

The State Board of Equalization proposes to adopt Rule 474 to implement and make specific the requirements for valuation of real property, personal property, and fixtures used for the refining of petroleum. Rule 474 defines "petroleum refining property" and establishes a rebuttable presumption, for purposes of recognizing declines in value, that land, improvements, and fixtures and other machinery and equipment classified as improvements constitute one appraisal unit, except when measuring declines in value caused by disaster, in which case land constitutes a separate appraisal unit.

The express terms of the proposed action, written in plain English, are available from the agency contact person named in this notice.

COST TO LOCAL AGENCIES AND SCHOOL DISTRICTS

The State Board of Equalization has determined that proposed Rule 474 does not impose a mandate on local agencies or school districts. Further, the Board has determined that the proposed rule will not result in direct or indirect costs or savings to any state agency, any costs to local agencies or school districts that are required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code, or other non-discretionary costs or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

EFFECT ON BUSINESS

Pursuant to Government Code section 11346.5, subdivision (a)(8), the Board of Equalization makes an initial determination that the adoption of Rule 474 will not have a significant statewide adverse economic impact directly affecting business because the proposed rule merely interprets and clarifies existing statutory provisions.

The rule will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

The adoption of the rule will not be detrimental to California businesses in competing with businesses in other states.

The rule will not affect small business because the new rule only interprets and clarifies property tax assessment law statutory provisions and does not impose any additional compliance or reporting requirements on taxpayers.

COST IMPACT ON PRIVATE PERSONS OR BUSINESSES

A cost impact of $1.4 million per year on directly affected persons or businesses is estimated. This does not represent a significant, statewide adverse economic impact on affected California businesses, as it represents a potential increase in assessed value of $140 million spread over a value base of approximately $32 billion, and the adoption of the rule does not impose any additional compliance or reporting requirements on private persons or businesses.

SIGNIFICANT EFFECT ON HOUSING COSTS

No significant effect.

FEDERAL REGULATIONS

Rule 474 has no comparable federal regulation.

AUTHORITY

Government Code section 15606, subdivision (a).

REFERENCE

California Constitution, article XIII, section 1 and article XIII A, section 2, and Revenue and Taxation Code section 51.

CONTACT

Questions regarding the substance of the proposed rule should be directed to: Ms. Carole Ruwart, Senior Tax Counsel, at P.O. Box 942879, 450 N Street, MIC:82, Sacramento, CA 94279-0082. Telephone: (916) 322-3682; FAX (916) 323-3387.

Written comments for the Board's consideration, requests to present testimony, bring witnesses to the public hearing and inquiries concerning the proposed administrative action should be directed to Ms. Diane Olson, Regulations Coordinator, (916) 322-9569, and P.O. Box 942879, 450 N Street, MIC:80, Sacramento, CA 94279-0080.

ALTERNATIVES CONSIDERED

The Board must determine that no reasonable alternative considered by it or that has otherwise been identified and brought to its attention would be more effective in carrying out the purpose for which this action is proposed or be as effective and less burdensome to affected private persons than the proposed action.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATIONS

The Board has prepared an initial statement of reasons and an underscored version (express terms) of the rule. Those documents and all information on which the proposal is based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. Requests for copies should be addressed to Ms. Diane Olson, Regulations Coordinator, (916) 322-9569, at P. O. Box 942879, 450 N Street, MIC:80, Sacramento, CA 94279-0080. The express terms of the proposed regulation (rule) are available on the Internet at the Board's website http://www.boe.ca.gov.

AVAILABILITY OF FINAL STATEMENT OF REASONS

The final statement of reasons will be made available on the Internet at the Board's website following its public hearing of the adoption of the rule. It is also available for public inspection at 450 N Street, Sacramento, California.

ADDITIONAL COMMENTS

Following the hearing, the State Board of Equalization may, in accordance with law, adopt the rule if the text remains substantially the same as described in the text originally made available to the public. If the State Board of Equalization makes modifications which are substantially related to the originally proposed text, the Board will make the modified text, with the changes clearly indicated, available to the public for 15 days before adoption of the regulation. The text of the modified rule will be mailed to those interested parties who commented on the proposed regulatory action orally or in writing or who asked to be informed of such changes. The modified rule will be available to the public from Ms. Olson. The State Board of Equalization will consider written comments on the modified rule for 15 days after the date on which the modified rule is made available to the public.

Rules/474/Notice

REVENUE STATEMENT

REGULATION: Rule 474
Petroleum Refining Properties

The State Board of Equalization proposes to adopt Rule 474, Petroleum Refinery Properties, to implement and make specific the requirements under article XIII, section 1, and article XIII A, section 2, of the California Constitution for the valuation of real property, personal property, and fixtures used to refine petroleum. The proposed rule: (1) defines "petroleum refining property" and (2) establishes a rebuttable presumption that, for purposes of recognizing declines in value, land, improvements, and fixtures and other machinery and equipment classified as improvements for a petroleum refining property constitute a single appraisal unit, except when measuring declines in value caused by disaster, in which case land constitutes a separate appraisal unit. A $1.4 million annual revenue increase to local government is anticipated as a result of the adoption of the proposed rule because declines in value of fixtures would be offset by the increased value of land and structures unless the presumption is rebutted.

Source: Approved Board Meeting Minutes

_____ Date _____
Deputy Director, (Department)

_____ Date _____
Assistant Chief Counsel, (Department)

_____ Date _____
Manager, Statistics Section

_____ Date _____
Chief, Board Proceedings Division

ESTIMATE OF COST OR SAVINGS WORKSHEET

Regulations: Property Tax Rule 474

Title: 18

*Yes	No	
/ /	/x/	Imposes mandate on local agencies or school districts [Government Code section 11346.5, subdivision (a)(5)].
/ /	/x/	If yes, does mandate require state reimbursement pursuant to Part 7 (commencing with section 17500) of Division 4 of Title 2 of the Government Code?
/ /	/x/	Cost or savings to any state agency.
/ /	/x/	Cost to any local agency or school district required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of Title 2 of the Government Code.
/ /	/x/	Non-discretionary cost or savings imposed on local agencies.
/ /	/x/	Cost or savings in federal funding to state.
/x /	/ /	Cost impact on private persons or businesses directly affected [Government Code section 11346.5, subdivision (a)(9)].
/ /	/x/	Significant adverse economic impact on businesses [Government Code section 11346.5, subdivision (a)(8)].
/ /	/x/	Effect on business including the ability of California business to compete with business in other states.

*If yes, attach separate sheet with explanation.

NOTE: SAM section 6056 requires that estimates resulting in costs or savings must be submitted for Department of Finance concurrence before the notice of proposed regulatory action is released.

Prepared by: Carole Ruwart Date: _____

Cost Impact on Private Persons or Businesses Directly Affected [Government Code 11346.5, subdivision (a)(9)]

Under proposed Property Tax Rule[1] 474, *Petroleum Refining Properties*:

(1) Declines in value of petroleum refining properties will be determined by comparing the current lien date full value of the appraisal unit to the indexed base year full value of the same unit.

(2) The land, improvements, and fixtures and other machinery and equipment classified as improvements for a petroleum refining property are rebuttably presumed to constitute a single appraisal unit, except when measuring declines in value caused by disaster, in which case land shall constitute a separate unit.

Currently, fixtures are always a separate appraisal unit for the purpose of measuring declines in value under Rule 461. When fixtures are treated as a separate appraisal unit, a decline in their value, e.g., depreciation, may be independently recognized.

Under proposed Rule 474, fixtures may be considered part of a larger appraisal unit that also includes land and non-fixtures improvements. Under this treatment, a decline in the value of fixtures could be offset by an increase in the value of the associated land and improvements other than fixtures resulting in an assessed value that would be greater than or equal to the sum of the values produced under the current rules.

The revenue effect of not always treating fixtures as a separate appraisal unit for declines in value is extremely difficult to estimate due to the many factors involved and their lack of predictability. Among the factors are the following:

1) The amount of decrease in value of those fixtures that are not treated separately.
2) The amount of offsetting increase in value for the associated land and non-fixtures improvements.

The Western States Petroleum Association reports that there are 20 major refineries located in California. Nine of the refineries are located in two counties: five are located in Los Angeles County and four in Contra Costa County. County data show the total assessment to be over $14 billion with approximately 79 percent ($11 billion) enrolled as fixtures. Projecting this information on a statewide basis indicates Rule 474 potentially affects the assessment of $32 billion of refinery property of which $25 billion consists of fixtures.

Since the non-fixtures property value is relatively small when compared to the fixtures, any increases (short of the extreme) in their market value are easily absorbed by the depreciation in the fixtures. This means that under the proposed rule the property would be assessed at market value, except in the rare instance where the market value exceeds the Proposition13 factored base year value.

For the 20 large petroleum refining properties in California that would be assessed by combining fixtures with other real property, the total difference in assessed value for the offsetting increase for land and structures is conservatively estimated to be: $7 billion x 2%, or $140 million.

---

[1] All references to Property Tax Rules are section references to title 18 of the California Code of Regulations.

The total difference in assessed value under the proposed rule is estimated to be at least $140 million. The difference in property tax from the basic 1 percent property tax rate is then $1.4 million.

The actual revenue effect could be considerably higher or lower depending on the number of properties that would be actually affected by this treatment and the actual amount of offsetting values.

Rules/474/Cost.doc

SUMMARY OF PROPOSED ADOPTION OF PROPERTY TAX RULE 474, PETROLEUM REFINING PROPERTIES

Rule 474 clarifies the requirements under article XIII, section 1, and article XIII A, section 2, of the California Constitution for the valuation of real property, personal property, and fixtures used to refine petroleum.